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STATE OF MICHIGAN
OFFICE OF FINANCIAL AND INSURANCE SERVICES
DEPARTMENT OF LABOR & ECONOMIC GROWTH
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BILL ANALYSIS

BILL NUMBER: House Bill No. 4834 (As Introduced)
TOPIC: Deferred Presentment Services
SPONSOR: Representative McConico
CO-SPONSORS: Representatives Hunter, Leland, Ward, Brown, Adamini, Mayes, Clemente, Dillon, Accavitti, Gillard, Farrah, Hune, Palsrok, Williams, Lipsey, Lemmons Jr., Kolb, Condino, Wojno, Hildenbrand, Green, Cheeks, and Lemmons III
COMMITTEE: House Banking and Financial Services
Analysis Done: June 2, 2005

POSITION

The Office of Financial and Insurance Services (OFIS) does not support this proposed legislation.

PROBLEM/BACKGROUND

In recent years, the deferred presentment (also known as payday lending or payday advance) business has become increasingly prevalent and profitable in Michigan. While these deferred presentment providers (DPPs) provide a valuable service, without regulatory oversight, abuses can occur and Michigan consumers can be placed in financial jeopardy. Currently, DPPs are not clearly subject to any state regulatory control or oversight. Additionally, they charge a fee for each deferred presentment transaction that, when calculated as an annual percentage rate (APR), can exceed 400%, far exceeding the 25% permitted for loans under Michigan's usury laws.

DPPs, often located in strip malls or outside of manufacturing plants or military bases, offer a service to individuals who find themselves short of funds between paychecks; a convenient short-term access to cash that they cannot or choose not to get from other sources. The process is quite simple and increasingly popular throughout the state. Without restrictions on the amount loaned per transaction, the fees charged for the service, and the number of times an individual may extend or roll a loan over, an individual can find him or herself in an ever-deepening financial hole.

Legislation is needed to provide a regulatory framework that is designed to prevent fraud, abuse, and other unlawful activity associated with payday lending. The payday lending industry is seeking a regulatory framework that will protect the industry from pending and future class action lawsuits alleging violations of Michigan's usury laws. Because such legislation will remove any remaining doubt whether the fees DPPs may charge in Michigan are subject to the usury limits of 25% APR, the legislation must place limits on the ability of DPPs to prey on and reap overly generous financial benefits (profits) from Michigan consumers who find themselves in need of short-term, emergency cash.

DESCRIPTION OF BILL

House Bill 4834 would create the "deferred presentment services act" (act) that requires DPPs to be licensed and regulated by OFIS. The bill prescribes appropriate conduct for DPPs and grants regulatory oversight and enforcement powers to OFIS.

House Bill 4834 does the following:

Requires a separate license for each location from which the business of deferred presentment services is conducted.

Requires an applicant for a license to have and a licensee to maintain net worth of at least \$50,000.00 for each licensed location up to a maximum of \$250,000.00 in required liquid assets for any one licensee.

Requires an applicant to demonstrate to the Commissioner that the applicant has the financial responsibility, financial condition, business experience, character, and general fitness to reasonably warrant a belief that the applicant will conduct its business lawfully and fairly.

Authorizes the Commissioner to review relevant business records, the competence, integrity, and financial ability of any individual who is a member, partner, director, officer, or a shareholder with 10% or more interest in the applicant; any record concerning the applicant or any of the above-named individuals of any criminal activity, fraud, or other act of personal dishonesty, an act, omission, or practice that constitutes a breach of fiduciary duty or any administrative action against an applicant taken by any agency or department of the United States or any state.

Requires a licensee to pay a license fee within 60 days of submitting its license application and annually thereafter.

Requires the Commissioner annually to establish a schedule of license fees based on each licensee's business volume, number of locations, and any other business factors deemed reasonable by the Commissioner to generate revenue sufficient to meet but not exceed OFIS' reasonably anticipated costs of administering the act.

Requires a licensee to pay the actual travel, lodging, and meal expenses incurred by OFIS employees who travel out of state to examine the records of or investigate the licensee.

Requires that money received under this act be deposited in the Department of State Treasury to be used solely for the operation of OFIS.

Requires each licensee to furnish a surety bond of \$50,000.00, issued by a bonding or insurance company, to secure performance of its obligations.

Requires each licensee to post a copy of its license in a conspicuous location at its place of business.

Provides that the license shall remain in effect through the remainder of the fiscal year ending September 30 after its date of issuance, unless earlier surrendered, suspended, or revoked.

Requires the prior written approval of the Commissioner for the continued operation of a deferred presentment services business if there is a change in control of a licensee.

Requires a licensee to notify OFIS fifteen days before any change in the licensee's business location or name.

Requires specific notices to be posted in an area designed to be seen by customers.

Requires specific provisions to be contained in written deferred presentment services agreement.

Requires the Commissioner to make available any order or regulation issued within a reasonable time after issuance to each licensee.

Authorizes the Commissioner to annually examine the business, books, and records of any licensee and requires the licensee to pay the cost of the examination.

Requires each licensee to preserve the books, accounts, and records for at least three years, unless applicable state or federal law requires a longer retention period.

Limits the amount of each transaction to \$500.00. An individual may have a total of two transactions open at any one time, but not more than one with the same licensee.

Requires that before signing an agreement, the customer certify that he or she does not have an outstanding transaction with that licensee and does not have more than one outstanding transaction with another licensee. A customer who provides this certification in violation of the law is not eligible for restitution, despite the duty otherwise being on the licensee to check the database for this information.

Limits the fee for the transaction to 15% of the amount of the transaction, plus a \$5.00 verification fee. The fee is earned at the time of the transaction and is not interest. The licensee cannot charge any interest or other amount in excess of the allowable fee.

Prohibits a licensee from renewing transactions and from charging any additional amounts for extending the transaction.

Gives customers a self-help remedy similar to that contained in the "item-pricing" law. Customers may, within a limited time, present evidence of a violation to the licensee and the licensee must determine if it agrees with the customer. If the licensee agrees, it must return the check and fees and pay restitution equal to five

times the amount of the fee charged, but not less than \$15.00 or more than the face amount of the check. Paying restitution bars the customer from seeking any further redress for that violation. If the licensee does not agree, it may present the check for payment or enter the check into the check-clearing process on or after the maturity date. If the customer still believes that the licensee violated the law, he or she may file a written complaint including supporting documents or other evidence with OFIS. If after investigating the customer's complaint, the Commissioner determines that the licensee violated the act, the Commissioner may order the licensee to make restitution to the customer in an amount equal to three times the above-stated amount of restitution provided to the customer, but not less than \$45.00 or more than three times the full amount of the check. Payment of restitution under these circumstances does not bar further action by the Commissioner under the act.

Allows a customer to rescind contracts by the close of the next business day and to redeem checks by paying the face amount of the check at any time before the maturity date stated in the agreement.

Provides that a customer who rescinds a deferred presentment services agreement is not eligible for restitution with regard to the rescinded agreement.

Bars a licensee from seeking criminal penalties against a customer because the customer entered into an agreement or his or her check is dishonored.

Bars a licensee from presenting a check for payment before the maturity date.

Bars a licensee from including in a deferred presentment services agreement a confession of judgment.

Permits a customer to file written complaints against licensees with OFIS.

Provides that a person which provided deferred presentment services before a specific date is considered to have complied with applicable state law if the person provided the services in conformity with the rulings and interpretive statements then in effect that were issued by OFIS or its predecessor agency.

Provides for the implementation of a statewide common database and allows the Commissioner to contract with a third party provider for the database. A statewide, common database is necessary for the effective implementation and administration of this new regulatory program.

SUMMARY OF ARGUMENTS

Pro

Due to recent media attention identifying problems in this industry, regulatory oversight needs to be designed to protect Michigan consumers from fraud, abuse, and other unlawful activity associated with payday lending. Legitimate business entities engaged in providing deferred presentment services need clear-cut rules to follow. Multi-state deferred presentment services firms are reluctant to do business in states without DPP licensing statutes. Deferred presentment services firms also seek the protection against

lawsuits, filed by consumers who believe they have been harmed, that this legislation would provide.

OFIS needs to be able to effectively administer a program of licensing and regulating deferred presentment providers and this legislation does contain a clear mandate to establish a statewide, common database of regulatory, licensing, and transactional information. A centralized database will give OFIS a cost-effective and affordable audit process for monitoring compliance. It is the only effective way for OFIS to monitor transaction activity in order to identify patterns of suspicious activity soon after they occur. Since only licensed providers would have access to the database, OFIS could more easily identify and pursue unlicensed activity. OFIS could use the information in the database to closely target field examinations and to address identified problems, making the best use of scarce resources.

A centralized regulatory database is the most efficient way to effectively prevent the spiraling cycle of short-term consumer debt that entraps the most vulnerable users of deferred presentment services. A centralized regulatory database is needed to effectively enforce the dollar amount and rollover limits in the bill. Licensees would be required to make internet-based checks of the database to verify customer eligibility. Additionally, the legislation specifies privacy of the information and provides for important limitations on the use of the data to protect Michigan consumers from unlawful use of that highly sensitive information.

The bill will make it a licensee's responsibility to check the database for the eligibility of each customer, gives a procedure to follow in case the database is not operational or not available to the licensee, and provides that a licensee who violates the act cannot initiate a civil action against a customer who may not have been eligible.

This legislation would "grandfather" in those who are offering this service on the effective date of the act. The provisions clarify that an existing payday lender could continue to operate but would be required to file an application by utilizing a process and a timeline established by OFIS after the effective date of the act. This contemplates that the act will take immediate effect at some time in 2005 or early 2006. By taking immediate effect, the act would prohibit any new company from starting to offer the business without a license from OFIS. After the act takes effect, once timelines can be established, OFIS would publish the process and the dates by which existing payday lenders would have to apply. The new language also states that a license issued before October 1, 2006 could be extended for more than a 12-month period, the normal life of a license, to expire on September 30, 2007. This would allow OFIS time to issue a license to a payday lender in 2005 or early 2006, and not be required to renew it on October 1, 2006. This flexibility gives OFIS better tools to handle the bubble of license applications we are likely to receive once the new act takes effect.

Con

OFIS has a number of concerns with provisions contained within this proposed legislation. Among those concerns are the following:

Senate Bill 474, which was vetoed in 2004 based in large part upon the unreasonable rate within, contained a maximum transaction fee of 13.25% that was to be calculated on the face amount of the check rather than on the amount of the advance. The calculation of that fee resulted in an actual maximum of 15.27%¹. That amount would have equated to an APR of almost 400% on a 14-day loan.

House Bill 4834 contains a maximum transaction fee of 15% on the amount of the advance, along with a \$5.00 verification fee. The calculation of that fee results in an actual maximum of 16%². That amount equates to an APR of 417% on a 14-day loan. This bill results in a fee that is higher than the bill that was vetoed last session.

While people may be willing to pay this amount today in an unregulated environment, OFIS believes that Michigan consumers should receive greater protection if the Legislature is going to impose a fair regulatory program, including immunity from lawsuits, over this industry. The State of Florida, through its Legislature and signed into law by Governor Jeb Bush, enacted a 10% fee in its deferred presentment legislation. In that state, the estimated 2003 annual growth rate is 15.3 percent for deferred presentment branch locations and 47.1 percent for number of customers. (See "2003 Annual Program Report to the Legislature" by the Florida Office of Financial Regulation dated January 1, 2004.)

Additionally, if the bill moves forward with revisions that correct the issues above, OFIS requests an amendment to the language requiring that money received under the act be deposited in the Treasury to be used solely for the operation of OFIS. Section 14(3) on page eight needs to be revised to specify that the fund be an interest-bearing account. The revised subsection (3) needs to read as follows:

"(3) Money received under this act shall be deposited in **AN INTEREST BEARING ACCOUNT IN** the state treasury and credited to the office to be used only for the operation of the office."

FISCAL INFORMATION

Because of the increased duties placed upon OFIS, more staff time will need to be devoted to reviewing license applications, conducting investigations and examinations, issuing orders and rulings, promulgating rules, responding to consumer complaints, and

¹ A customer writes a check for \$500.00. The face amount of the check multiplied by the authorized fee ($500 \times .1325 = 66.25$) is \$66.25. The fee is subtracted from the check so that the customer receives cash (or a negotiable instrument that they can convert to cash) of \$433.75. When the fee paid is divided by the cash received ($66.25 \div 433.75 = .15274$), an effective rate of 15.274% is the result.

² If the transaction is for \$500.00, the fee of 15% equals \$75.00 plus a \$5.00 verification fee. When the total fees paid are divided by the cash received ($80.00 \div 500.00 = .16$), an effective rate of 16% is the result.

enforcing penalties associated with the violations contained in the legislation. This substantially increased activity will divert staff from other necessary functions unless OFIS is able to add staff to perform the new functions.

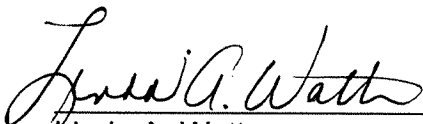
To adequately perform its new responsibilities under the legislation without diverting resources needed for other functions, OFIS will need legislative authority to hire at least an additional five FTEs. While it is difficult at this time to measure the fiscal impact of the new duties contained in this act, the inclusion of the statewide, common database adequate to automatically perform many of the new duties would reduce the estimated number of FTEs necessary to perform the regulatory functions if no database were provided.

ECONOMIC IMPACT

None known.

ADMINISTRATIVE RULES IMPACT

Rules can be promulgated to provide for administration of the act.



Linda A. Watters
Commissioner

6-7-05

Date